Controlling Market Power

Balancing Antitrust and Sector Regulation in Telecoms

Among the countries fully liberalizing their telecommunications sector, some have chosen to rely mainly on sector-specific rules, often applied by sector-specific institutions, while others have depended on economywide antitrust rules and institutions to control market power. This Note describes the choices made by five notable reformers: Australia, Chile, New Zealand, the United Kingdom, and the United States. Drawing on their experiences, it then assesses whether antitrust or sector-specific processes have dealt more quickly and effectively with key regulatory issues.

The regulatory frameworks for telecommunications adopted at different times by the five countries reflect different balances between antitrust and sector-specific approaches (table 1).

The United States has emphasized a sector-specific approach. It adopted the Telecommunications Act of 1996 to bring down all barriers to competition in the telecommunications market and, especially, to enable long-distance operators to enter the local markets previously monopolized by the regional local operators. The Telecommunications Act contains no less than 335 pages of sector-specific regulations, and the Federal Communications Commission (FCC), the sector-specific agency in charge of applying these rules, employs more than 2,100 staff.

In New Zealand, by contrast, the regulatory model adopted at the end of the 1980s relied largely on general antitrust rules and institutions. This framework was modified in 2001 to introduce sector-specific rules, such as those on interconnection, number portability, carrier preselection, and roaming. In addition, a telecommunications commissioner with specialized staff was appointed to the antitrust authority.

Chile, the United Kingdom, and Australia adopted what were in effect compromises between the more radical U.S. and (pre-2001) New Zealand approaches. A pioneer in liberalizing telecommunications, Chile had to learn largely by trial and error. The rules adopted in the early 1980s to allow multiple entry into each market segment contained few sector-specific provisions (and few licenses were awarded early on to new entrants). Additional sector-specific provisions were adopted in
1987 (on tariff setting) and in 1994 (on inter-
connection, vertical separation between the local
and long distance markets, and choice of long
distance carriers on a call-by-call basis). While a
sector-specific regulator was established as early
as 1977, antitrust authorities remain important,
since they determine, for example, whether the
prices of particular telecommunications services
need to be regulated.

In the United Kingdom until very recently,
sector-specific rules were mostly included in
operators’ licenses and implemented by OfTEL,
the telecommunications regulator. But the
sector regulator could also enforce economy-
wide antitrust rules contained in the Compe-
tition Act of 1998. Since 2003 individual
licenses have been replaced by a general
authorization regime, and sector-specific reg-
ulation is being curtailed in favor of general
competition law. In addition, OfTEL has been
replaced by OfCOM, a somewhat broader com-
munications regulator also responsible for
broadcasting and cable.

In Australia the Telecommunications Act of
1997 removed all restrictions on entry into the
telecommunications market and introduced a
sophisticated set of access rules as well as other
specific rules relating to, for example, number
portability, operator preselection, and override
dial codes. These sector-specific rules are
applied by antitrust authorities.

Successes of antitrust
Reliance on antitrust yielded some good results
when the courts intervened to stop clear abuses
of dominant positions. In a dispute over local
loop interconnection in New Zealand, for exam-
ple, judges agreed that the incumbent, Telecom,
was abusing its dominant position relative to its
competitor Clear when it forced Clear’s cus-
tomers to dial an access code and imposed on
Clear the same interconnection price paid by
any of Telecom’s large end users with their own
switches. In Chile antitrust authorities took
action to prevent the incumbent provider of
local services (CTC) from offering discounts to
its own subscribers, but not to others, on certain
fixed-to-mobile services.1

Antitrust provisions have also been successfully
applied in merger controls. In Australia operators
chose to cancel merger plans when antitrust
authorities announced that the proposed merg-
ers would probably violate the antitrust law. Sim-
ilarly, in the United States MCI WorldCom and
Sprint decided to call off their planned merger
after antitrust authorities declared that the trans-
action would reduce competition. And in Chile a
statement by antitrust authorities that a merger
between the local operations of the incumbent
and those of a cable operator would eliminate a
promising source of local competition persuaded
the two operators to substantially revise their
merger plans.

### Table Balance between antitrust and sector-specific regulation of telecommunications

<table>
<thead>
<tr>
<th>Country</th>
<th>Rules</th>
<th>Institutions</th>
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<tr>
<td>Australia</td>
<td>Mix of sector-specific and antitrust rules, with most sector-specific rules integrated into general antitrust legislation</td>
<td>Antitrust authorities with telecommunications group</td>
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<tr>
<td>Chile</td>
<td>Mix of sector-specific and antitrust rules</td>
<td>Sector-specific regulator</td>
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<td></td>
<td></td>
<td>Distinct antitrust authorities</td>
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<tr>
<td>New Zealand</td>
<td>Before 2001, predominantly antitrust</td>
<td>Before 2001, antitrust authorities</td>
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<tr>
<td></td>
<td>Since 2001, a mix of sector-specific and antitrust rules</td>
<td>Since 2001, antitrust authorities with telecommunications commissioner</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Before 2003, predominantly sector-specific (included in licenses)</td>
<td>Sector-specific regulator with antitrust powers</td>
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<td>Since 2003, general authorization regime with increasing reliance on competition law</td>
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<tr>
<td>United States</td>
<td>Predominantly sector-specific</td>
<td>Sector-specific regulator</td>
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<td>Distinct antitrust authorities</td>
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Shortcomings of antitrust

Antitrust-based regulation appears to have some drawbacks, however. Interconnection issues, for example, have often been difficult to resolve through antitrust. In New Zealand the Clear-Telcase posed a big challenge to the regulatory model before the 2001 reforms: judicial processes aimed at determining a fair interconnection price lasted several years, different courts took different positions on the same issues, and in the end judges refused to set a price, leaving the parties to reach a specific agreement conforming to broadly defined principles.

Unbundled access to the local loop and resale of local services have generally not taken place under an antitrust-based regime such as that adopted in New Zealand. For unbundling, however, specific regulation has not necessarily yielded better results. One main reason is that determining adequate pricing and other conditions of access to distinct unbundled elements of a given network is far from straightforward.

Agreement on number portability, carrier preselection, and roaming also proved difficult to reach in New Zealand without sector-specific rules. Some operators reached an agreement on number portability in 1999, but the government had to threaten to intervene at several stages and the process took a long time. Preselection agreements for long distance fixed-to-fixed calls were also negotiated commercially before the 2001 reforms. But preselection for fixed-to-mobile calls did not exist, nor did roaming.

Control of retail prices also proved problematic under antitrust. In Chile, for example, the pricing provisions of the 1982 General Law of Telecommunications were vague, and prices were set through informal negotiations between incumbent companies and the Ministry of Economy. Prices were set at inefficient levels, cross-subsidization between services was maintained, and antitrust authorities did not intervene to correct the situation. Only after the adoption of more specific provisions were these problems corrected.

Even in merger controls, applying antitrust provisions may not always promote competition. In many countries antitrust merger provisions are designed to prevent behaviors that would lessen competition and so are inadequate to foster competition in sectors where no competition existed before. In the United States, for example, where the local market was divided into regional monopolies before adoption of the Telecommunications Act of 1996, antitrust provisions cannot prevent a merger between two incumbent local operators.

Antitrust provisions are also ill suited to imposing general structural remedies such as vertical separation between different segments of the telecommunications market. In Chile, after long antitrust proceedings in the courts to determine whether the incumbent provider of local services and the incumbent provider of long distance services could compete in each other’s market, it was the legislature that clarified the situation by imposing some vertical separation between the two market segments.

All five countries have relied on sector-specific rules to ensure that universal service objectives are met and to regulate the allocation and use of the radioelectric spectrum. In both cases such rules are needed to optimize the allocation of scarce public resources: public subsidies funding universal service schemes in the first case, and the spectrum in the second.

Striking the right balance

The experiences of the five countries suggest that sector-specific rules are needed to:

- Specify interconnection prices and conditions.
- Set the prices of resale services and perhaps the conditions under which the incumbent should provide unbundled access to the local loop (though experience suggests that designing and implementing adequate unbundling rules is extremely difficult).
- Allow number portability, carrier preselection, and roaming.
- Control end-user prices in market segments where competitive pressures remain weak, such as that for fixed local calls.
- Impose certain types of structural remedies, such as vertical separation between different market segments.
- Define and fund universal service objectives and allocate rights to use the radioelectric spectrum.

Antitrust rules also remain essential in all five countries, to:
Deal with a range of issues of economic regulation not addressed by the sector-specific rules above (for example, to ensure merger reviews and prohibit anticompetitive practices).

Fill any gaps in sector-specific regulatory regimes.

The experiences of the five countries also suggest that specialized entities are needed to deal with some of the most complex issues requiring regulatory intervention in telecommunications. Both a sector-specific agency (with or without antitrust powers) and an economywide antitrust entity with sufficient expertise in telecommunications may be well suited to the job.²

There appears to be growing convergence among the five countries toward the balance suggested here between sector-specific and antitrust regulation. For example, Chile and New Zealand, which had few sector-specific rules when they liberalized their telecommunications markets, have subsequently adopted such rules. Conversely, the United Kingdom, whose framework initially relied heavily on sector-specific provisions, has shifted toward more emphasis on antitrust.

Convergence can also be observed on institutional issues. Indeed, since the 2001 reforms in New Zealand, all five countries have established either a sector-specific regulatory agency or a specialized department within an economywide antitrust authority.

The way forward

The spread of new technologies is likely to facilitate competition in the local segment of the telecommunications market in the five countries. This, in turn, is likely to allow progressive relaxation of some sector-specific regulation. For example, as new local service providers become more numerous and more competitive, the incumbent will face greater incentives to offer them equitable interconnection conditions. Long distance and mobile operators will also find it easier to conclude favorable interconnection agreements when they can negotiate with any one of a number of local service providers. As a result, a sector-specific interconnection price regime may some day become unnecessary.

Greater competition in the local loop may also eliminate the need to regulate end-user prices. Indeed, as competition has taken hold, the Australian, Chilean, and U.S. regulators have progressively reduced the number of telecommunications services subject to price regulation.

More intense competition in the local loop would thus shift the appropriate balance between the two regulatory approaches toward economywide rules. And a move toward greater reliance on economywide rules would bolster the case for entrusting an economywide rather than a sector-specific regulator with controlling market power in telecommunications. Some steps in that direction have already been taken. Australia opted to entrust its competition authority with responsibility for regulating telecommunications. New Zealand has now followed suit. And the United Kingdom recently replaced its telecommunications-specific regulator with a broader communications regulator, emulating the United States, where the FCC’s competence extends to both telecommunications and broadcasting.

Notes

1. What constitutes an abuse of dominant position varies with market conditions and with the intensity of competitive pressures. Free or discounted on-net calling between fixed and mobile phones is now allowed in some countries where there is enough competition.

2. This does not mean, however, that the authority of a specialized regulator should necessarily extend to every sector-specific rule listed. For example, given the broad socioeconomic implications of universal service regimes, specialized regulators—especially if they focus on one sector only—may not be best placed to administer such regimes.

Reference


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